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SUBJECT: KUWAIT'S BIG INFRASTRUCTURE PROJECTS FAIL TO LAUNCH

REF: A. KUWAIT 585

[1](#)B. KUWAIT 273

[1](#)C. KUWAIT 163

Classified By: Ambassador Richard LeBaron for reasons 1.4 (b) and (d).

[1](#)1. (C/NF) Summary and Comment: Several important state-sponsored infrastructure projects in Kuwait have been delayed for a number of years for largely bureaucratic and political reasons. These projects includes power plants, desalination plants, a mega-refinery, a major container port, and a variety of real estate development projects. The need for new infrastructure investment is becoming a pressing issue as Kuwait's population and economy continue to expand and consumption of government subsidized utilities remains extraordinarily high. With strong economic performance and an Amir who wants to reform and diversify Kuwait's economy, the problem is not a lack of awareness of what needs to be done or lack of resources. Failure of the Government and Parliament to produce needed legislation and fundamental problems with Kuwait's government contracting system are the causes most frequently cited by developers and contractors in Kuwait. The contracting system has failed to account for changes that have occurred in the GCC construction market in recent years. Consequently, Kuwait's infrastructure development is lagging behind that of its GCC neighbors as the leading contractors seek better opportunities elsewhere in the Gulf. These delays have been costly for Kuwait as construction costs have grown. One local developer estimates that delays in implementing several major projects have already cost Kuwait about \$50 billion. In the short term, under-investment in infrastructure is expected to result in electricity and water shortages this summer. In the long run, under-investment will seriously hamper plans to attract foreign direct investment, promote private sector growth, and diversify the economy. End Summary and Comment.

Several Major Projects Continue to Languish

[1](#)2. (SBU) A number of major state-sponsored infrastructure projects have been delayed for periods ranging from three to ten years, for a variety of political and bureaucratic reasons. The largest of these projects include:

-- Al-Zour North Electrical Plant - a \$3 billion (est.), 2500 MW thermal power plant and associated desalination plant originally proposed in 1998 to meet Kuwait's rapidly growing, and now under-supplied, power demand.

-- Mina Al-Zour Refinery - a \$12 billion (est.), 615,000 bpd refinery first proposed in 2004 to produce clean burning fuel

for Kuwait's power plants, boost exports of refined products, and allow for the decommissioning of the aging and accident-prone Shuaiba refinery.

-- Boubiyan Island Container Port - a \$6 billion (est.) project to dredge a 25-mile approach channel and construct a new nine-berth port and 2.5 million TEU container terminal supported by a new bridge, railway, and road on the uninhabited, swampy Boubiyan Island which sits between the Iraqi port of Umm Qasr and mouth of the Shaat Al-Arab waterway, which separates Iraq and Iran. Construction was supposed to begin in 2006.

-- Failaka Island Touristic Development - a \$5 billion (est.) project to develop "Islamic family tourism" on the 43-square-kilometer island located 20 miles off the coast of Kuwait, including hotels, chalets, and leisure and entertainment facilities supported by a new power plant and desalination plant. Contracts were supposed to be awarded in 2005.

-- Silk City - an \$86 billion (est.) project to build a new commercial and residential city on the Subiyah peninsula located 20 miles across the bay from Kuwait City. The project includes housing, commercial structures, schools, and hospitals to accommodate 500,000 residents on a 250-square-kilometer plot. Design studies were completed in March 2006.

-- Subiyah Causeway (a.k.a. Jaber Al-Sabah bridge) - a \$1 billion (est.), 20-mile causeway across Kuwait Bay to link the Silk City to Kuwait City. Design work began in early 2005.

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No Shortage of Capital, or Demand

13. (C/NF) Delays in major infrastructure investment are clearly not due to a shortage of resources or a failure of Kuwait's leaders to recognize the need for such investment. Real GDP growth in 2005 was 8.5%. Kuwait's GDP per capita of \$28,100 is higher than that of UAE, Saudi Arabia, and Bahrain. Supported by high oil prices in 2006, Kuwait produced an estimated budget surplus of about \$17.5 billion (20% of GDP) and a current account surplus of \$40 billion (45% of GDP). Since becoming head of state in 2006, Amir Shaykh Sabah Al-Ahmed Al-Jaber Al-Sabah has repeatedly articulated his vision of diversifying the national economy away from hydrocarbons and promoting growth in the private sector to make Kuwait a regional center for trade and finance. The majority of Post's contacts in the Government and the Parliament recognize that continued economic growth (estimated at 6% by the IMF), population growth (estimated at 5% by the Economist Intelligence Unit), the goal of attracting more foreign direct investment, the desire to promote the growth of local private companies, and extraordinarily high per capita consumption of electricity (which for a population of about 3 million reaches a summertime peak of 9500 MW) and water (108 gallons per person per day according to the Ministry of Electricity and Water) will require investment in many of the projects listed above.

Yet, despite the strength of the key economic indicators, all of the above projects remain stuck on the drawing board. There is now a 12-year backlog in providing housing to Kuwaiti citizens, and this summer, for the second year running, Kuwait is expected to experience significant power and water shortages. Most observers blame the delays on politics and the bureaucracy of public development projects in Kuwait.

Political Obstacles

¶4. (C/NF) Ongoing antagonism between the Government and Parliament has made it difficult to pass new legislation that could address many of the weaknesses of Kuwait's public contracting system. In the past 18 months, friction between MPs and Ministers led the Amir to dissolve the Parliament once and appoint a new Government three times. Draft legislation including a new tax law (which would lower the tax rate on foreign companies from 55% to 15%), a proposed BOT (Build-Operate-Transfer) law, and a revised public properties law would make it easier for the Government to review, approve, and execute plans for development on government-owned land (which comprises more than 95% of the total land area in Kuwait) through partnerships with both foreign and domestic private companies. However, little key legislation has recently come to a vote in Parliament, partly due to the Government's failure to outline and implement a clear development plan and crack down on corruption, and partly due to many MPs' focus on obtaining more government benefits for their constituents. The presence of multiple small, political/religious blocs within the Parliament with frequently shifting alliances makes it difficult to pass any legislation that one or more of these blocs might oppose. In the meantime, Engineer Hussain Mansoor Ziyab, Chief of Mega Projects at the Ministry of Public Works, says the Ministry will not proceed with the execution of any major projects until the BOT law and public properties law are approved.

¶5. (C/NF) The current Parliament was elected in June 2006 largely on an anti-corruption, pro-reform platform. There have long been allegations of corruption associated with the awarding of public contracts to private companies as influential developers, contractors, and commercial agents have reportedly used bribery and wasta (connections) either to win contracts for themselves or to persuade the State Audit Bureau or Central Tenders Committee to prevent contracts from being awarded to their commercial and political rivals. American contractors who do business with the Ministries complain that mid-level officials are not empowered with any real authority, so all substantive decisions are raised to the Ministerial level. Following a series of highly politicized BOT-related corruption scandals in late 2006, the newly appointed Ministers seem risk-averse and reluctant to propose, promote, or approve any new BOT projects until the political climate improves.

Institutional/Bureaucratic Impediments

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¶6. (SBU) Both foreign contractors and local developers in Kuwait complain to Post that public contracting rules, structures, and terms and conditions are out-of-date and not in-tune with those of other countries in the region. U.S. contractors and consultants cite the main problems as being:

- A perceived lack of transparency and the absence of a level playing field in the awarding of contracts;
- A statutory requirement that contractors accept unlimited liability for projects;
- Terms and conditions that do not reflect current market conditions by failing to account for the current costs of labor and materials, and the explosive growth in demand for contractors' services in the region;
- Excessively high tax rates applied to non-Kuwaiti companies;
- An offset program which, for most major projects, requires contractors to contribute up to 35 per cent of total contract value to collateral projects that contribute to Kuwait's economic development;
- Long and unnecessary delays in payment from the Government;
- The requirement that foreign companies work through Kuwaiti agents who frequently demand exorbitant commissions while adding little value;

- Contracting exclusively on a lump sum - turnkey basis rather than cost-reimbursable basis;
- Demands for excessive customization of turnkey engineering projects which would normally be standardized;
- Excessively rigid work schedules that limit the flexibility of managers to adapt to unforeseen circumstances; and
- Contracts awarded strictly on the basis of cost without accounting for quality.

¶7. (U) A survey of the GCC construction market conducted by the Middle East Economic Digest (MEED) states that with "overflowing order books, material price inflation, aggressive construction schedules, and increasingly tight labor markets," overall contract value for the fifty leading contractors in the Gulf increased by 24 per cent from 2005 to ¶2006. According to MEED, "The supply and demand imbalance between projects and contractors means that good contractors can afford to be choosy.... Good contractors are in short supply across the Gulf and clients have been forced to become more flexible. Payment terms have improved and new procurement methods are being introduced as clients have become more amenable to sharing risk with a contractor." MEED estimates that EPC (Engineering-Procurement-Construction) bid prices have risen by 20-30 per cent in the past year alone. It states that, "The market has turned full circle for EPC contractors over the past five years and now they hold the upper hand." American contractors and consultants in Kuwait say that the Kuwaiti Government contracting apparatus has failed to adapt to these market realities. In Kuwait's electricity and water sector alone, over the past two years, four of the biggest power generation and desalination tenders have been unable to attract more than one bid, resulting in all either being re-tendered or canceled outright.

Embassy Actions

¶8. (C/NF) The Embassy frequently raises these issues with the Kuwaiti Government and helps American companies to navigate the hazards of the Kuwait public contracting system. Following a meeting on 21 April with new Minister of Electricity and Water Mohammed Abdullah Al-Elaim (Ref. A), the Ambassador provided the Minister with a non-paper outlining the most common criticisms of Kuwait's public contracting system as voiced by American contractors and consultants. This non-paper, which included the points from paragraph six (above), emphasized aspects of the Kuwaiti system that represent a significant departure from common practices in other countries in the region and, in turn, inhibit Kuwait's ability to attract competitive bids in a tight regional construction market. Post's Commercial Section (FCS), in cooperation with international accounting firms and corporate law firms operating in Kuwait, frequently advises American companies on the technical aspects and cost implications of Kuwait's tax code and offset program. FCS also helps these companies to incorporate specific language into their commercial contracts with Kuwaiti partners and agents so as to reduce their exposure to the risk posed by unlimited liability. Post's Economic Section, with the support of the Office of the U.S. Trade Representative,

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continues to advocate for reform of Kuwait's tax law and offset program under the auspices of the USG-GOK Trade and Investment Framework Agreement (TIFA). These efforts contributed to the drafting of a new tax law which would lower the maximum tax rate on foreign companies from 55 per cent to 15 per cent. The draft legislation has been endorsed by the Parliament's Financial and Economic Affairs Committee but has yet to be ratified by the full Parliament. The Ambassador hosted a lunch on May 29 with leading local tax experts to discuss further areas for possible U.S. advocacy. These experts saw little possibility of early tax reform

legislation, but were pleased to report that they were winning tax cases in the courts for a variety of U.S. and other foreign firms faced with unfair tax liabilities.

The Costs of Falling Behind

¶9. (SBU) Kuwait Commercial Markets Complex Company (KCMCC), a major Kuwaiti real estate development company, estimates that delays in executing major infrastructure, energy, and housing projects have cost the Government of Kuwait approximately \$50 billion as construction costs in the region have skyrocketed over the last few years. Talal Sulaiman Al-Marhash, KCMCC's Executive Director, says that the development situation is unlikely to improve as long as "necessary legislation remains stalled"; "the Parliament continues to focus only on distributing wealth to citizens" through public salary increases, subsidies, and consumer loan forgiveness; and "the Government provides no leadership." Al-Marhash believes the problems of parochialism, patronage, and populism in the Parliament could be reduced by the establishment of formal political parties. He adds that "modernizing, private-sector voices" that could spur greater progress remain muted in Kuwait, so he intends to promote the formation of an "economic lobby" comprised of leading figures in the private sector to advocate for necessary reforms. The Kuwait Chamber of Commerce has long been an advocate of reforms, but is largely controlled by firms that are doing very well under the current system.

¶10. (U) A study of major construction projects around the region demonstrates that Kuwait is lagging behind its GCC neighbors, and many major international contractors have given up on Kuwait in favor of better opportunities elsewhere in the Gulf. According to two recent surveys of the Gulf construction and power markets published in MEED, more than half of fifty leading contractors in the GCC secured new contracts in the UAE last year, while 35 per cent reported orders in Qatar. In contrast, no major international contractors, with the exception of Athens-based CCC, secured any contracts in Kuwait. The relatively small number of construction contracts that were awarded in Kuwait in 2005 and 2006 were mostly captured by five local Kuwaiti contractors. According to the MEED survey, of \$32 billion in overall contract value distributed among the fifty major contractors in the GCC in 2006, only \$1.6 billion (five per cent) was awarded for contracts in Kuwait.

¶11. (C/NF) In the near term, the Government of Kuwait's recent history of under-investment in electricity and water is expected to result in significant shortages and brownouts this summer (ref. B). Over the long term, under-investment in public infrastructure overall will limit the country's ability to attract foreign direct investment, hamper the Government's ability to provide basic public services, and ultimately constrain Kuwait's economic growth. Post's contacts in the construction sector generally believe the situation will need to reach the level of a crisis before the Government will be spurred to make the necessary systemic changes in the public contracting process required to alleviate the problem of under-investment in major infrastructure projects.

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LeBaron